

2-22-2008

# Deferring Crop Insurance and Disaster Payments: How Not to Do It

Robert P. Achenbach Jr  
*Iowa State University*

Follow this and additional works at: <http://lib.dr.iastate.edu/aglawdigest>



Part of the [Agricultural and Resource Economics Commons](#), [Agricultural Economics Commons](#), [Agriculture Law Commons](#), and the [Public Economics Commons](#)

---

## Recommended Citation

Achenbach, Robert P. Jr (2008) "Deferring Crop Insurance and Disaster Payments: How Not to Do It," *Agricultural Law Digest*: Vol. 19 : No. 4 , Article 2.

Available at: <http://lib.dr.iastate.edu/aglawdigest/vol19/iss4/2>

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in *Agricultural Law Digest* by an authorized editor of Iowa State University Digital Repository. For more information, please contact [digirep@iastate.edu](mailto:digirep@iastate.edu).



## Agricultural Law Press

Publisher/Editor  
Robert P. Achenbach, Jr.  
Contributing Editor  
Dr. Neil E. Harl, Esq.  
\* \* \* \*

### Issue Contents

#### Animals

Animal cruelty 35

#### Bankruptcy

General

Discharge 35

Mortgage loans 35

Federal Taxation

Sale of Chapter 12 estate property 35

#### Federal Agricultural Programs

Crop insurance 35

Freedom of information requests 36

Grapes 36

#### Federal Estate and Gift Taxation

Disclaimers 36

Trusts 36

#### Federal Income Taxation

2008 Tax rebate 36

Alternative fuel credit 36

Corporations

Adjusted basis election 36

Compensation 37

Dependents 37

Depreciation 37

Employee benefits 37

Foreign income 37

General welfare 37

Hybrid vehicle credit 37

Like-kind exchanges 38

Low income housing credit 38

Medical expenses 38

Partnerships

Basis adjustment election 38

Check-the-box election 38

Investment income 38

Returns 38

Safe harbor interest rates

March 2008 39

S Corporations

Bad debts 39

Sale of shares 39

Tax shelters 39

#### Negligence

Trees 39

#### Products Liability

Tractor 40

#### Property

Boundary fence 40

# Agricultural Law Digest

Volume 19, No. 5

March 7, 2008

ISSN 1051-2780

## Deferring Crop Insurance and Disaster Payments: How Not to Do It

-by Neil E. Harl\*

Since it was enacted in 1969,<sup>1</sup> the provision authorizing a one-year deferral to the year after the year of “destruction or damage to crops”<sup>2</sup> has drawn very little attention. Other than Treasury Regulations,<sup>3</sup> a 1974 revenue ruling<sup>4</sup> a notice issued in 1989<sup>5</sup> and assorted other (mostly minor) rulings,<sup>6</sup> the subsection, which has been important to many farmers, has provoked little scrutiny by the Internal Revenue Service and has not been litigated.

That is not to say that questions have not been raised, notably over the issue of what kind of historical record is necessary to support a one-year deferral of crop insurance proceeds and disaster payments. The statute refers only to a requirement that the taxpayer must establish “. . . that, under his practice, income from such crops would have been reported in a following taxable year.”<sup>7</sup> A 2008 Tax Court case, for the first time, has examined that and other language in the brief provision that authorizes a deferral of income.<sup>8</sup>

### The framework for deferral

For nearly 40 years, farmers on the cash method of accounting have been allowed to elect to include crop insurance and disaster payments in income in the taxable year following the taxable year following the crop loss.<sup>9</sup> That has been possible if, under the taxpayer’s practice, income from the sale of the crop would have been reported “in a following taxable year.”<sup>10</sup> Crop insurance and disaster payments must be treated the same way if received in the same taxable year and if the payments were from the same trade or business.<sup>11</sup>

A taxpayer may not elect to defer only a portion of the insurance proceeds to the following year.<sup>12</sup> Thus, the election cannot be used to manage fluctuations in income tax liability by deferring a portion and reporting the remaining amount currently.<sup>13</sup>

On the issue of the threshold requirement for deferral, that the income without the loss would have been reported “. . . in a following taxable year,” the 1974 ruling went well beyond the statutory language<sup>14</sup> which was unclear and ambiguous. The ruling determined that the taxpayer which was the subject of the ruling established that a substantial part of the crops (more than 50 percent) would have been reported in the following year.<sup>15</sup>

\* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

The taxpayer was eligible to elect to defer the entire amount at issue. In the facts of the ruling, the farm taxpayer was engaged in producing several crops. In every instance, the taxpayer had a history of deferring more than 50 percent of the crop.

#### **Nelson v. Commissioner**

In the 2008 Tax Court case, *Nelson v. Commissioner*,<sup>16</sup> two related farm partnerships in Minnesota were involved in the production of sugar beets and, in one of the partnerships, other crops as well. The taxpayers had been following what the Tax Court referred to as a “method of allocation” whereby 65 percent of the sugar beet crop was arbitrarily reported in the year the crop was harvested and 35 percent the following year.<sup>17</sup> The court noted that similar formulas were utilized for the other crops produced.

The Tax Court delicately sidestepped the propriety of such an allocation. Without must question, this would have been an unauthorized method of accounting. The law is well settled when a crop becomes subject to income tax unless the transaction comes within an exception such as the deferral provision in question in this case.<sup>18</sup>

The Tax Court instead focused on the narrow issue of whether the taxpayers were eligible to defer crop insurance proceeds under those facts. The Tax Court agreed with IRS that the 35 percent of crops carried over was not sufficient to support the deferral of the entire amount of crop insurance proceeds. The court discussed, approvingly, the attempt in *Rev. Rul. 74-145*<sup>19</sup> to provide more specific guidance than was afforded by the statute and held that 35 percent carried over was less than substantial (which has been interpreted as more than 50 percent).<sup>20</sup> The Tax Court specifically rejected the argument that deferral of only a small portion of the crop historically would allow deferral of 100 percent of the crop insurance proceeds (and disaster payments) currently where a loss has occurred, which is what the taxpayers were trying to do.

#### **The larger picture**

An obvious question is whether such “methods of allocation” as were in evidence in *Nelson v. Commissioner*<sup>21</sup> are widespread and, if so, whether the Service will make an effort to address that aspect of the problem as an unacceptable method of accounting. The case of *Nelson v. Commissioner*<sup>22</sup> has provided a measure of fortification to *Rev. Rul. 74-145*<sup>23</sup> which had come under some pressure as an allegedly arbitrary guideline, arguably higher than Congress intended.

#### **FOOTNOTES**

<sup>1</sup> Tax Reform Act of 1969, Pub. L.No. 91-172, §215(a), enacting I.R.C. § 451(d). See generally 4 Harl, *Agricultural Law* § 27.03[7][a] (2008); Harl, *Agricultural Law Manual* § 4.02[4] (2008); 1 Harl, *Farm Income Tax Manual* § 2.13[1] (2007 ed.).

<sup>2</sup> I.R.C. § 451(d).

<sup>3</sup> Treas. Reg. § 1.451-6.

<sup>4</sup> Rev. Rul. 74-145, 1974-1 C.B. 113.

<sup>5</sup> Notice 89-55, 1989-1 C.B. 696.

<sup>6</sup> Notice 90-28, 1990-1 C.B. 339.

<sup>7</sup> I.R.C. § 451(d).

<sup>8</sup> *Nelson v. Comm’r*, 130 T.C. No. 5 (2000).

<sup>9</sup> I.R.C. § 451(d).

<sup>10</sup> I.R.C. § 451(d).

<sup>11</sup> Notice 89-55, 1989-1 C.B. 696.

<sup>12</sup> Rev. Rul. 74-145, 1974-1 C.B. 113.

<sup>13</sup> *Id.*

<sup>14</sup> See Rev. Rul. 74-145, 1974-1 C.B. 113.

<sup>15</sup> *Id.*

<sup>16</sup> 130 T.C. No. 5 (2008).

<sup>17</sup> *Id.*

<sup>18</sup> I.R.C. § 451(d).

<sup>19</sup> 1974-1 C.B. 113.

<sup>20</sup> Rev. Rul. 74-145, 1974-1 C.B. 113.

<sup>21</sup> 130 T.C. No. 5 (2008).

<sup>22</sup> 130 T.C. No. 5 (2008).

<sup>23</sup> 1974-1 C.B. 113.

**The Agricultural Law Press  
has moved.**

Our new address is:

**Agricultural Law Press**

**P.O. Box 835**

**Brownsville, OR 97327**

**Ph. 541-466-5444**

**Fax 541-466-3311**